

WHATCOM COUNTY WATER DISTRICT NO. 10
Whatcom County, Washington
January 1, 1995 Through December 31, 1995

Schedule Of Findings

1. The District's Materials Inventory Control System Should Be Strengthened

As noted in our previous audits of Whatcom County Water District No. 10, the inventory system had the following weaknesses:

- a. The district does not have written policies governing access to, purchase, and usage of materials inventory.
- b. There is a lack of controls to ensure all materials purchased and used are included in the expense reports.
- c. There is a lack of controls to ensure all items are correctly and consistently priced.
- d. Almost all of the district employees have access to inventory.
- e. Annual physical inventories are not reconciled to actual material records.

The district had not addressed these weaknesses by the end of the current audit.

RCW 43.09.200, Local government accounting - Uniform system of accounting, states in part:

The state auditor shall formulate, prescribe and install a system of accounting and reporting for all local governments, which shall be uniform for every public institution, and every public office, and every public account of the same class

The State Auditor's Office has prescribed Bulletin 401, *Proprietary Accounting Procedures*; Section I.B. Internal Control, states in part:

Introduction - This section contains the internal control standards to be followed by local governments in establishing and maintaining systems of internal control. Internal control systems are to reasonably ensure that the following objectives are achieved:

Expenditures and commitments comply with applicable law.

Assets are safeguarded against waste, loss, unauthorized use, and misappropriation.

Transactions are recorded properly so that reliable financial and statistical reports can be prepared and accountability for assets is maintained

The American Institute of Certified Public Accountant's (AICPA) in its *Codification of Statements on Auditing Standards*, AU Section 319, Appendix D, states in part:

Establishing and maintaining an internal control structure is an important management responsibility. In establishing specific internal control structure policies and procedures concerning an entity's ability to record, process, summarize and report financial data that is consistent with management's assertions embodied in the financial statements, some of the objectives management may wish to consider include the following:

- Transactions are executed in accordance with management's general or specific authorization.
- Transactions are recorded as necessary (1) to permit preparation of financial statements in conformity with generally accepted accounting principles or any other criteria applicable to such statements and (2) to maintain accountability of assets.
- Access to assets is permitted only in accordance with management's authorization.
- The recorded accountability for assets is compared with existing assets at reasonable intervals and appropriate action is taken with respect to any differences.

Access to Assets:

The objective of safeguarding assets requires that access be limited to authorized personnel. In this context, access to assets includes both direct physical and indirect access through the preparation of processing documents that authorize the use or disposition of assets. Access to assets is required in the normal operations of a business and, therefore, limiting access to authorized personnel is the maximum feasible constraint. The number and competence of personnel to whom access is authorized should be influenced by the nature of the assets and the related susceptibility to loss through errors and irregularities. Limitation of direct access to assets requires appropriate physical segregation and protective equipment or devices. (Emphasis added.)

The district did not implement basic internal controls over its materials inventory, making it difficult to hold individuals accountable for their own activities. As a result, the district cannot ensure inventory is adequately safeguarded to discourage theft and other irregularities. In addition, accounting records cannot be relied upon to determine the accurate costs of inventory charged to projects.

We recommend the district:

- a. Develop and implement a materials inventory system to improve the district's accountability over inventory.
- b. Implement adequate controls to ensure all inventory purchased and used is accurately recorded in the accounting records.
- c. Develop and implement controls over materials inventory pricing to ensure inventory is correctly and consistently priced.
- d. Restrict access to materials inventory to a limited number of employees responsible for the control of the inventory.
- e. Reconcile physical inventories to material records.

Auditee's Response

On March 18, 1996, the new District staff position of Maintenance Planning Technician was filled and implemented. The responsibilities of this staff position include:

- *Implement a materials inventory system.*
- *Reconcile physical inventories to materials records.*
- *Manage access of employees to inventory.*
- *Record and track inventory.*

On February 12, 1997, the Commissioners directed the General Manager to continue the development and implementation of a materials inventory system. The District has reduced inventories substantially in 1996. Levels will be reduced further in 1997 to reach an inventory level considered "statistically insignificant." In addition, the Commissioners intend to complete the following actions no later than July 1, 1997:

- *Develop a materials inventory control policy and implement a materials inventory system.*
- *Record all inventory purchased.*
- *Implement controls over inventory pricing.*
- *Restrict access to materials to a limited number of employees.*
- *Reconcile physical inventories to materials records.*

2. The District's Fixed Asset System Should Be Strengthened

As noted in our previous audits of Whatcom County Water District No. 10, the fixed asset system had the following weaknesses:

- a. There is a lack of a written fixed asset policy.
- b. Physical inventories are not performed on a periodic basis.

- c. There are inadequate fixed asset system controls to ensure all changes in assets are recorded and included in the fixed asset records.
- d. All district maintenance and office equipment is not marked with identification tags and asset serial numbers are not recorded in the district's asset records.

The district had not addressed these weaknesses by the end of the current audit.

RCW 43.09.200, Local government accounting - Uniform system of accounting, states in part:

The state auditor shall formulate, prescribe and install a system of accounting and reporting for all local governments, which shall be uniform for every public institution, and every public office, and every public account of the same class

The State Auditor's Office has prescribed Bulletin 401, *Proprietary Accounting Procedures*. Section V.A. of the Bulletin, Fixed Asset System Requirements, states in part:

General Requirements

Accountability for fixed assets is required of all local governments, regardless of size. In addition, fixed asset accounting is required for cities and counties of over 8,000 population and for any governmental enterprise (such as an airport or a water utility) or special purpose district (library, fire district, water or sewer district, etc.) if operating revenues exceed half a million dollars

The Bulletin further states on page 76:

V.B. Establishing a Fixed Asset System

Designing and establishing your fixed asset accounting system requires systematic planning . . .

Establishing the objectives of the fixed asset systems and making permanent policy decisions which will shape both the initial establishment of your fixed asset inventory and maintenance of the system.

The Bulletin further states on page 90:

V.E. Updating the Fixed Asset System: Physical Inventory

A physical inventory of the fixed assets is necessary to verify that the assets still exist; it also provides updates on the condition of the assets. This information demonstrates that your entity is exercising its custodial responsibility for the asset and is beneficial when establishing an insurance claim because it substantiates both the existence and the condition of the asset near the time of loss or damage

The Bulletin further states on page 81:

V.D. Updating the Fixed Asset System: Accounting

Once the fixed asset system is in operation, your government needs to make sure that assets which should be capitalized are properly recorded and that records are brought up to date when assets are disposed of

. . . .

The weaknesses noted above are the result of the district not allocating enough time and resources to ensure an adequate system is in place.

The lack of adequate policies, procedures, and controls over fixed assets increases the likelihood that errors and/or irregularities could occur and go undetected by the district. In addition, the absence of updated maintenance records and physical inventories may inhibit the district's ability to prove any losses as a result of theft or damage when establishing an insurance claim.

We recommend the district:

- a. Develop and implement a fixed asset policy to increase the district's accountability for fixed assets.
- b. Perform periodic fixed asset physical inventories and reconcile those inventories to the fixed asset records.
- c. Implement adequate system control to ensure all fixed asset acquisitions and dispositions are properly entered in the fixed asset records.
- d. Implement procedures which identify all assets by identification tag and serial number.

Auditee's Response

Since January 24, 1996, the District has used fixed asset policy adopted by the Commissioners to differentiate expensed vs capitalized purchases. On September 11, 1996, the Commissioners directed the General Manager to begin the preparation of a data base that will include a Computerized Maintenance Management System (CMMS). In addition, the Commissioners intend to complete the following actions no later than July 1, 1997:

- *Develop a fixed asset policy.*
- *Identify fixed assets by identification tags and serial number.*
- *Reconcile fixed assets to records.*

Auditor's Concluding Remarks

We would like to express our appreciation to Whatcom County Water District No. 10 for its written response to our audit report and for the efforts made to comply with our recommendations. The improvements will be reviewed during the course of the next regularly scheduled audit. We would also like to take this opportunity to thank the staff throughout the district for their assistance and cooperation during the audit process.